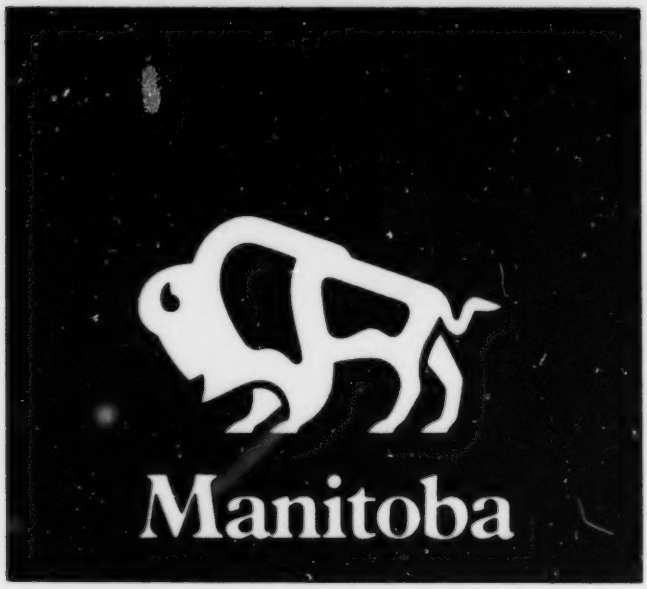

Manitoba's position on:

National Tax Reform

Hon. Howard Pawley
Premier of Manitoba

Annual Conference of First Ministers
Halifax, Nova Scotia:
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MANITOBA POSITION PAPER ON:

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MANITOBA'S POSITION ON TAX REFORM:

A SUMMARY

The Manitoba Government has consistently argued that national tax reform is urgently required to restore fairness to taxation and to provide the resource base necessary to sustain public programs. A return to fair taxation is a basic requirement to maintain vital services and programs needed by Canadians. It is also a prerequisite to the improved fiscal flexibility senior Governments must have in order to undertake the fresh initiatives needed to meet the emerging challenges of the economic and social transformation now underway.

The importance of acting quickly and purposefully in this matter cannot be overemphasized. The relentless shifting of the income tax burden from the wealthy to working Canadians has created a pervasive cynicism among ordinary taxpayers. This trend must be reversed. In recent years, the responsiveness of income tax revenues to economic growth has decreased. Manitoba has emphasized the links between inadequate income tax revenues, growing deficits, and diminished fiscal flexibility. Manitoba is also deeply concerned that tax policy decisions and initiatives must bear a large part of the blame in these developments.

The Honourable Mr. Michael Wilson's comments, as reported on March 26, 1985 in the Winnipeg Free Press reinforce these concerns:

> "There are some funny things going on in tax collections...we have kept greater control of spending but tax collections over the last few months have been less than what we had expected and I can't give you the answers because we don't know the answers."

The federal Auditor General has estimated that the federal government gives up as much as $35 to $50 billion of tax revenues each year in the form of special concessions, exemptions, exclusions and incentives. The "Account of the Cost of Selective Tax Measures" published in August, 1985 by the federal Finance Department tends to confirm the Auditor's estimate. Unlike grants, departmental spending or programs, however, these tax expenditures go virtually unscrutinized by Parliament. There is no accountability either for the fairness, the need or the effectiveness of these measures.

Unfortunately, Mr. Wilson's May 23, 1985 Budget did not address the tax reform issue in any meaningful way. Instead, the measures proposed added immensely to the existing inequities within the income tax system. Analysis of the effect of the changes proposed in the Budget on Manitoba taxfilers, shows large benefits accruing to a very small group of high income taxfilers, along with a significant reduction in ordinary Manitobans' disposable incomes. Patterns in other provinces are expected to be very similar. The Manitoba Government does not support this type of redirection in the pattern of burdens and benefits.

Manitoba has argued for a minimum tax on high income individuals and profitable corporations as an initial stop-gap measure designed to halt the erosion of income tax revenues. A minimum tax must not, however, be

allowed to deflect the sense of urgency for general, comprehensive tax reform. There is real concern that the minimum tax may only represent a diversion from the real task of restoring fundamental equity to our national tax system.

The Manitoba Government is concerned that the growing inability of the income tax system to generate adequate revenues has led many governments to incur increased deficits, to cut resources for vital programs and services, and to rely on other forms of taxation unrelated to ability-to-pay. Senior Canadian governments must begin to re-examine the national tax system in a new light, to answer some difficult questions about the objectives and results of the past policies. The present cycle of further erosion of the income tax base and the growing pressure on vital programming must be reversed.

1. Fairness

The cumulative effects of federal tax policy over the last dozen years have made significant base-broadening tax reform more than a desirable objective. Tax reform is now urgently required.

A significant and growing number of ordinary Canadians no longer believe the income tax system is just. Moderate and middle income working Canadians are asked to pay more, while a host of new tax giveaways are offered to other well-to-do taxfilers with the financial and professional resources to take advantage of them. This pattern was augmented in a major way by the most recent federal Budget.

This growing sense of unfairness -- as well as the increased complexity -- has also contributed to the increasing levels of non-compliance with our self-assessing income tax system.

2. Proliferation of Tax Preferences

Among other effects, the proliferation of preferences has led to a self-perpetuating "vicious circle" of unproductive competition among various sectors and interests to attain the covetted "most favoured" status within the income tax incentive system. Investors seeking tax shelters are often in a position where the tax benefits of various provisions completely outweigh any consideration of the economic risks inherent in the activities themselves.

For example, some sectors which already enjoy very significant incentives have suggested that the Scientific Research Tax Credit measures in effect last year absorbed a significant portion of the funds which otherwise might have been invested in their industries. The solution does not involve yet another round of enriching all the existing incentives.

3. Accountability: Costs and Effectiveness

Manitoba has pointed out that the national tax system has experienced significant erosion and revenue losses through the introduction of numerous preferences, deductions, and incentives. Thorough review of the effectiveness of these measures is long overdue:

- Did measures like savings incentives, investment income preferences, business investment tax credits, accelerated Capital Cost Allowances, result in more investment than would otherwise have occurred? Or were incentives simply used to finance activities which would have occurred in any case.

- What were the effects on employment? Did the firms taking advantage of incentives simply displace other employers in their industries (by creating unfair advantages for some firms)? Did the incentives simply free funds which were used to support higher-than-otherwise dividends? Did they free funds used for investments outside of Canada?

- What were the costs, in terms of revenue lost, of the achievements (if any) relative to other means of achieving these policy objectives?

- Which measures have been the most efficient in promoting policy objectives?

Unfortunately these questions have not been addressed to date. The available evidence (which was usefully summarized in a 1980 Canadian Tax Foundation study), while tentative and incomplete, is largely pessimistic on these questions. Unless persuasive, empirical evidence is found to support the relative merits of pursuing economic objectives through taxation measures as opposed to other methods, governments at all levels should focus on ensuring that the tax system collects adequate revenues fairly and progressively. This, after all, is the primary objective of any tax system in a civilized society.

4. 1985 Federal Budget

It is difficult to interpret the 1985 federal Budget as representing any progress in achieving tax reforms along the lines sought by the Manitoba Government:

- The measures which broaden the tax base either confirm previously announced initiatives (elimination of the SRTC mechanism) or are of relatively minor significance (elimination of the RHOSP deduction, gradual decreases in the child exemption, restrictions on some income-splitting measures). As tenants and families with

children are singled out, it could be argued that the RHOSP deduction and the child exemption changes are regressive in the context of the other new preferences introduced.

- The $500,000 lifetime exemption on capital gains income and the increased pension plan deductions have a much larger effect than the base-broadening measures and/or any of the minimum tax proposals.

- The income tax surcharges -- both corporate and personal -- are temporary and are applied to the existing (or rather, significantly narrowed) base.

- The Budget proposes to permit companies to transfer unused deductions and losses to profitable entities within a corporate group. This will result in significant reduction of corporation income tax payable. Any base-broadening measures are presented as "revenue neutral" (i.e. offset by rate reductions).

All the available evidence suggests that the 1985 federal Budget measures, considered as a package, represent a step back from achieving income tax reform. Canadians' perceptions of the fairness of the system will not be enhanced and the revenue generating capacity of the personal and corporate income taxes appear to have been compromised significantly.

EFFECTS OF THE MAY 23, 1985 FEDERAL BUDGET ON MANITOBA TAXFILERS: PERSONAL INCOME TAX AND CHILD BENEFIT CHANGES

I. INTRODUCTION

The May 23, 1985 federal Budget introduced a number of important changes to Canada's system of taxes and income transfers. Some of the proposals, for example, the plan to partially de-index Old Age Security pensions, and to include a variety of medications in the federal sales tax base, have been rescinded or modified. Nevertheless, the remaining provisions represent a major shift in the pattern of taxation and income support in Canada.

This paper outlines the effects of the most important of these changes on Manitoba individuals and households. The results of two approaches are presented. The first approach involves calculating the impact of the changes for several hypothetical, representative, household types. This approach isolates the effects on a given taxfiler type which result from the changes, at different income levels. For each comparison, family type and income composition are assumed to be essentially the same at each income level. This approach is useful in describing and illustrating the effects of tax and benefit changes on given types of taxpayers. This approach cannot tell us how many taxfilers are actually affected, nor by how much.

In actual fact, the types of taxpayers and the sources of income are not the same at different income levels. Senior citizens, single employees, and tenants are concentrated in the lower income portion of the income distribution, while families, homeowners, professionals, etc., are found more frequently within the upper middle and higher income ranges. The second approach -- which involves simulating the Budget changes for each case in a representative sample of taxfiler records -- gives a more accurate picture of the actual size of gains and losses resulting from the federal measures and their distribution among a variety of groups of taxfilers.

The simulation of these changes is complicated by the fact that the proposals are to be phased-in over a period ending with the 1990 taxation year. Many of the measures proposed -- de-indexation, child benefit changes, pension savings changes, etc. -- will not begin to affect Manitoba taxfilers until the 1986 taxation year. The paper discusses the effects of the changes for the current (1985) taxation year on Manitoba taxfilers, as well as the income tax and child benefit rules which have been proposed for the 1986 and 1990 taxation years after all the proposals are fully implemented. The impact of the changes on Manitoba families with children is examined in some detail.

II. TYPICAL TAXFILER ILLUSTRATIONS

Following are several tables showing the impact of the federal Budget measures on three types of taxfilers: an employee, a professional,

and a senior citizen, at various income levels. The illustrations focus on the combined effect of the personal income tax changes and the changes to the income support programs for two kinds of families, and for senior citizens. The tables compare the pre-Budget and post-Budget situations. Comparisons are made between the post-Budget rules projected to 1990 and the pre-Budget (status quo) rules for 1985 and as projected to 1990. The examples assume that the CPI will increase by 4% for each year up to 1990.

It should be noted that the assumptions made in preparing these tables -- composition of income, taxfilers' use of deductions, and indexing -- are quite arbitrary and the results would be affected if these assumptions were changed. The general patterns observed, however, would continue to hold under a fairly wide range of alternative assumptions. The net impacts on each illustrative taxfiler type are discussed below.

1. **Employee**

The table below illustrates the net impact of the Budget measures on a married individual with a dependent spouse and two children under age 18. The incomes shown are entirely derived from employment sources. The employee participates in an employer-sponsored pension plan and fully utilizes the available RRSP contribution limits. The table reflects the changes proposed to the family allowance system, the RRSP contribution rules, indexing of exemptions and tax brackets, the low income tax reduction, reductions in exemptions for dependent children, and the Child Tax Credit program.

TABLE I

CHANGES IN TAXES AND TRANSFERS:
MANITOBA EMPLOYEE FAMILY
(NET CHANGE IN 1990 AFTER-TAX INCOME)

Earned Income ($)	Net Change Relative to Pre-Budget System for 1985 ($)	As % of Income (%)	Net Change Relative to Pre-Budget System Projected to 1990 ($)	As % of Income (%)
20,000	<11>	<0.1>	<546>	<2.7>
25,000	30	0.1	<549>	<2.2>
30,000	18	0.1	<599>	<2.0>
50,000	371	0.7	<472>	<0.7>
75,000	906	1.2	<414>	<0.6>
100,000	1,637	1.6	<283>	<0.3>

(Figures in brackets indicate the taxfiler is worse-off.)

This table suggests that most Manitoba taxfilers who derive their income from employment will experience nominal, after-tax, income

gains relative to their pre-Budget 1985 income tax and transfer positions. (However, unless wage settlements exceed the inflation rate by about 3% annually, real "after tax" income will decrease significantly over this period.) The table also indicates that "gains" at moderate incomes both in absolute and relative-to-income terms are very marginal with higher gains at higher incomes.

By 1990, however, there are significant losses relative to the pre-Budget "status quo" situation. These reductions fall most heavily on lower income families. This pronounced regressivity is due almost entirely to the effect of the changes to the rules governing pension plan and RRSP contributions.

2. **Professional**

The next table shows the net impact of the Budget measures on a married self-employed professional with the same family circumstances as the employee. In these examples, it is assumed that a portion of the taxfiler's income is derived from capital gains. (The proportion increases from 5% of income at $30,000 to 30% at $100,000 of income). In addition to the impacts shown previously, this table also shows the effect of the expanded capital gains exemption.

TABLE II **CHANGES IN TAXES AND TRANSFERS: MANITOBA PROFESSIONAL FAMILY (NET CHANGE IN 1990 AFTER-TAX INCOME)**

Income ($)	Net Change Relative to Pre-Budget System for 1985 ($)	As % of Income (%)	Net Change Relative to Pre-Budget System Projected to 1990 ($)	As % of Income (%)
20,000	53	0.3	<486>	<2.4>
25,000	37	0.2	<542>	<2.2>
30,000	33	0.1	<555>	<1.9>
50,000	1,366	2.7	420	0.8
75,000	3,661	4.9	2,341	3.1
100,000	6,737	6.7	5,131	5.1

(Figures in brackets indicate the taxfiler is worse-off.)

The increased regressivity in this example (relative to the employee) is due primarily to the expanded capital gains exemption, and to a lesser extent the higher RRSP limits available to self-employed individuals. The sharp transition above the $30,000 income level is attributable to the (somewhat stylistic) manner in which capital gains as a proportion of total income are assumed to increase. It should be noted that in actual fact the contribution of capital gains to income -- and the benefit derived from the Budget changes -- will fluctuate widely around these roughly representative levels.

3. Senior Citizen

The final illustration shows the effect of the Budget changes on a single senior citizen. The income levels shown represent the senior citizen's income from non-OAS/GIS sources. This income is assumed to derive firstly from CPP, with the balance derived equally from private pension and investment sources. The net impacts include the effects of the partial de-indexing of income tax exemptions and the rate schedule, as well as the expanded capital gains exemption. **The table does not include the effect of the partial de-indexing of the OAS pension announced in the Budget but subsequently rescinded.**

TABLE III **CHANGES IN TAXES AND TRANSFERS: MANITOBA SINGLE SENIOR CITIZEN (NET CHANGE IN 1990 AFTER-TAX INCOME)**

Non-OAS/GIS Income ($)	Net Change in Taxes (vs. 1985) ($)	As % of Income (%)	Net Change in Taxes vs. Pre-Budget System for 1990 ($)	As % of Income (%)
0	170	2.3	0	0
5,000	105	1.1	<89>	<1.8>
10,000	46	0.3	<153>	<1.5>
20,000	523	2.2	257	1.3
30,000	1,061	3.2	755	2.5
50,000	2,670	5.0	2,088	4.2

(Figures in brackets indicate the taxfiler is worse-off.)

The patterns observed in these examples are roughly similar to those shown previously; all seniors in 1990 will experience some increases in nominal after-tax incomes relative to their 1985 situations. Many will lose significant benefits relative to the 1990 status quo tax/transfer regime. All taxable seniors face higher income tax burdens as a result of the diminished indexation of exemptions and tax brackets, and seniors with moderate taxable incomes will lose more as a result of the elimination of the low income tax reduction. Higher income seniors may have their losses offset if a significant portion of their income is derived from capital gains.

III. SIMULATION OF BUDGET PROPOSALS ON MANITOBA TAXFILERS

The impression that the Budget changes are highly regressive is supported by results of simulations of the changes on a sample of Manitoba taxfilers. The sample used for the simulations is based on the Manitoba portion of the national sample used by Revenue Canada to

generate the tables in its annual Taxation Statistics publication. The records in the sample have been adjusted to reflect the anticipated demographic and economic characteristics of the 1985 taxfiling population. Since a number of the changes will not be fully phased in until 1990, the tax/transfer regime in effect for each of the 1985, 1986, and 1990 taxation years are compared to the pre-Budget status quo rules. The changes affecting each taxation year are summarized in the chart below.

CHANGES INCLUDED/EXCLUDED IN SIMULATION OF BUDGET EFFECTS

Change	1985	1986	1990
Partial De-indexing of Exemptions, Rates, and Family Allowances	unaffected	Assumes Indexing Factor would have been at least 3% in each year to 1990	
Capital Gains Exemption	Uses Limits as announced for each year		
Pension Plan Contribution Limits	unaffected	Uses rates announced for each year	
RHOSP	Partially Eliminated	Fully Eliminated	
Child Benefits and Exemptions	unaffected	Levels set according to proposed schedule	
Federal Surtax	Applied at 1/2 of Full Rate	Fully Applied	not in effect
Federal Reduction	unaffected	Eliminated	Eliminated
The housing loans exemption, disability deduction extensions, limitations on income splitting and a variety of other minor changes cannot be simulated accurately. The measures will affect very few taxfilers, and the effect on the results is expected to be insignificant.			

It is important to remember that the results are not forecasts beyond the 1985 taxation year. The figures simply indicate what the effects would have been had the measures in effect in each taxation year been fully implemented in 1985. In other words, the simulations do not capture the effects of demographic and economic changes after 1985. In general, the simulations will underestimate the aggregate values of the effects for taxation years after 1985.

1. Changes for the 1985 Taxation Year

For the 1985 taxation year, Manitobans are expected to pay slightly less in total federal and provincial income taxes as a result of the Budget measures. Federal taxes payable will be approximately the same in total (down $6 million or 0.5%) and Manitoba taxes will be down about $7 million (or about 1%). (The Manitoba change is larger because the federal surtax does not affect provincial revenues). Since several of the most important changes; partial de-indexing of exemptions, tax rates and child benefits, as well as the new pension contribution limits, do not begin to take effect until the 1986 taxation year, only 72,000 (or 16%) of Manitoba taxfilers will experience changes in taxes of more than $10. (The tables and discussion in this and the following sections which refer to affected taxfilers or "gainers" and "losers" include only taxfilers whose total federal and provincial tax liabilities have changed by at least $10.00.) The following table shows the average changes in income taxes of taxfilers affected.

TABLE IV **IMPACT OF THE BUDGET PROPOSALS FOR 1985: MANITOBA TAXFILERS PAYING MORE AND PAYING LESS**

Income Group	Average Change in Taxes	% of Taxpayers Paying More	Average Tax Increase	% of Taxpayers Paying Less	Average Tax Decrease
	$	%	$	%	$
Under 7,500	88	2.3	195	1.1	123
7,500 - 15,000	(1)	3.5	279	3.4	292
15,000 - 25,000	38	7.4	360	4.5	488
25,000 - 50,000	(234)	12.6	228	8.2	945
50,000 and Over	(467)	69.8	325	21.7	3,020
All Affected Taxfilers	(179)	9.8	293	5.7	989

(Figures in parentheses refer to decreases in taxes.)

The table shows that the slight reduction in income taxes payable by Manitobans for 1985 is not expected to be distributed among all filers. About 10% of Manitoba taxpayers will pay an average of almost $300 more for 1985. With the exception of the lowest income group the average tax increase is quite uniform. The additional tax liability among lower income taxfilers arises primarily as a result of the cancellation of RHOSP contributions after May 22, 1985. Among higher income taxfilers the increased liabilities are due primarily to the federal surtax. The decreases in tax liabilities for the 1985 taxation year are due exclusively to the capital gains tax exemption. Taxpayers experiencing tax reductions are a very small group and are concentrated almost exclusively among higher income taxfilers.

The simulation also suggests that the increases and decreases in taxation liabilities are heavily concentrated in several occupational groups. The following table divides the 72,000 taxfilers whose federal and Manitoba income tax liabilities for 1985 have changed into major occupational groups. (Filers are classified by their primary income source).

TABLE V **IMPACT OF THE BUDGET PROPOSALS FOR 1985: MANITOBA TAXFILERS CLASSIFIED BY OCCUPATION**

Occupation	% of all Filers Affected (%)	Total Change ($M)	Average Change ($)	% Paying More (%)	% Paying Less (%)
Employees	68.3	4.3	88	77.2	22.8
Farmers & Fishermen	7.1	(7.8)	(1,524)	20.3	79.7
Professionals	3.3	0.1	36	78.7	21.3
Salesmen	0.2	-	162	48.5	51.5
Business Proprietors	2.4	(0.5)	(325)	53.4	46.7
Investors	15.2	(8.9)	(818)	26.0	74.0
Pensioners	3.0	-	(24)	31.4	68.6
All Others	0.6	-	(49)	30.5	69.5
All Groups	100.0	(12.9)	(179)		

(Figures in parentheses refer to decreases in taxes.)

People whose principal source of income is derived from employment represent 83.5% of the taxfilers who experience tax increases and absorb 77.1% of the total tax increases. Farmers (including fishermen) and investors (22.3% of taxfilers affected) represent 45.8% of taxfilers who experience tax decreases and receive 68.9% of the total tax decreases.

2. Changes for the 1986 and 1990 Taxation Years

Virtually all Manitoba taxpayers are affected by the Budget proposals for taxation years after 1985. Primarily as a result of the elimination of the federal low income tax reduction and lower-than-otherwise exemptions, about 61,000 (or 12.7%) more Manitoba taxfilers would be taxable if the rules proposed for 1990 were in effect for the 1985 taxation year. (About 98% of the "new" taxpayers have incomes of under $15,000). The following table shows the net impact of the tax changes on federal, Manitoba, and total liabilities.

TABLE VI **TOTAL TAX INCREASES UNDER BUDGET PROPOSALS FOR 1986 AND 1990 TAXATION YEARS**

	1986 Rules ($M)	1990 Rules ($M)
Federal Tax Payable	38.9	127.5
Manitoba Tax Payable	0.6	53.8
Total Tax Payable	39.5	181.3

It should be noted that the figures above -- and in subsequent comparisons in this section -- do not include the effects of a possible minimum tax (to date, the options have not been narrowed sufficiently to incorporate such a measure into the simulations). The tables do not include personal income changes due to the partial family allowance de-indexation and child tax credit changes. The effect of the Budget proposals on Manitoba families is discussed separately in Section IV.

The table below shows the distribution by income group, of the tax changes under the 1986 and the 1990 rules:

TABLE VII **AVERAGE IMPACT OF THE FEDERAL BUDGET PROPOSALS FOR 1986 AND 1990**

	Average Change in Total Taxes Payable	
Income Group ($)	Under 1986 Rules ($)	Under 1990 Rules ($)
Under 7,500	60	121
7,500 - 15,000	90	274
15,000 - 25,000	123	413
25,000 - 50,000	91	638
50,000 and Over	(547)	(1,286)
All Affected Taxfilers	77	338

(Figures in parentheses refer to decreases in taxes.)

The pattern of benefits -- among income groups -- becomes significantly more regressive under the tax rules for years after 1985. Considered as a group, only taxfilers with incomes over $50,000 benefit under the rules in effect for these years. The following table compares taxfilers who pay lower federal and provincial income taxes under the rules for the 1985, 1986 and 1990 taxation years. The total number of taxfilers in this situation increases slightly from 26,500 to 28,800 under the 1985 and 1986 proposals, respectively, and falls to 16,000 under the 1990 proposals.

TABLE VIII **AVERAGE IMPACT OF BUDGET PROPOSALS FOR THE 1985, 1986 AND 1990 TAXATION YEARS (MANITOBA TAXFILERS PAYING LOWER TAXES)**

Income Group ($)	Taxpayers Paying Less as % of all Taxpayers			Average Tax Decrease		
	1985 Proposals (%)	1986 Proposals (%)	1990 Proposals (%)	1985 Proposals ($)	1986 Proposals ($)	1990 Proposals ($)
Under 7,500	1.1	0.6	0.4	(123)	(96)	(100)
7,500 - 15,000	3.4	1.7	1.1	(292)	(445)	(518)
15,000 - 25,000	4.5	2.4	1.5	(488)	(845)	(1,126)
25,000 - 50,000	8.2	10.9	4.4	(945)	(909)	(1,731)
50,000 and Over	21.7	44.0	33.7	(3,020)	(2,204)	(6,348)
All Groups	5.7	5.6	3.0	(989)	(1,190)	(3,151)
Total Reduction ($M)	(26.2)	(34.2)	(50.3)			

(Figures in parentheses refer to decreases in taxes.)

In general, successively larger tax reductions will be divided among ever fewer, and higher income individuals as the measures initiated in the Budget mature.

Not surprisingly, both the number of taxfilers who pay more as a result of the proposed measures as well as the total tax liabilities increase significantly under the rules in effect for 1986 and 1990:

TABLE IX **AVERAGE IMPACT OF BUDGET PROPOSALS FOR THE 1985, 1986 AND 1990 TAXATION YEARS (MANITOBA TAXFILERS PAYING HIGHER TAXES)**

Income Group ($)	Taxpayers Paying More as % of Total Taxpayers			Average Tax Increase		
	1985 Rules (%)	1986 Rules (%)	1990 Rules (%)	1985 Rules ($)	1986 Rules ($)	1990 Rules ($)
Under 7,500	2.3	93.6	90.3	123	61	122
7,500 - 15,000	3.5	97.2	98.8	292	102	283
15,000 - 25,000	7.4	97.6	98.7	488	146	435
25,000 - 50,000	12.6	88.5	95.7	945	214	746
50,000 and Over	69.8	55.8	66.4	3,020	759	1,285
All Groups	9.8	93.4	96.0	989	153	445
Total Increase ($M)	13.3	73.7	231.6			

The "phasing-in" schedules proposed for the taxation years beginning in 1986 are largely responsible for the increasing concentration of the net beneficiaries at the highest income levels:

a) The elimination of the low income reduction and the partial de-indexation of personal exemptions are responsible for most of the tax increases, as well as for the growth in average tax liabilities among taxfilers under $25,000. These taxfilers generally do not have sufficient capital gains income for the new exemption to offset these increases. With the capital gains exemption rising in each year up to 1990, fewer and fewer taxfilers will have sufficient capital gains income to offset the tax-increasing components of the proposals.

   Similarly, the pension contribution limits are of exclusive benefit to fewer and higher income earners in each year after 1986. In fact, the reduction in the percentage -- from 20% to 18% -- of earned income which may be contributed to pension plans, as well as the new $2,000 maximum RRSP "top-up" for people with employer-sponsored plans ensures that average RRSP contributions are reduced among contributors with incomes under $20,000. (This observation is difficult to reconcile with the intended objective of the pension contribution changes; to encourage people to rely on their own savings for retirement income).

b) The partial de-indexation of the rate brackets is the most important factor increasing taxes among middle and higher

income taxfilers. The opportunities to offset these accumulating increases diminish significantly as the capital gains exemption and RRSP contribution limit increases are restricted to ever higher income taxfilers.

c) The elimination of the federal surtax after the 1986 taxation year also benefits higher income filers exclusively. The extent to which a minimum tax may offset this reduction is unclear. It might be noted, however, that all the minimum tax options considered to date are expected to raise less than the estimated $500 million (full year basis) surtax revenues.

The pattern of tax increases and decreases among occupational groups changes quite significantly in taxation years after 1985:

TABLE X **IMPACT OF THE BUDGET PROPOSALS FOR 1986 AND 1990: MANITOBA TAXFILERS CLASSIFIED BY OCCUPATION**

Occupation	1986 Proposals		1990 Proposals	
	Total Change ($M)	Average Change ($)	Total Change ($M)	Average Change ($)
Employees	47.6	119	181.0	443
Farmers & Fishermen	(5.6)	(265)	0.6	25
Professionals	(0.1)	(21)	(2.9)	(590)
Salesmen	0.1	166	0.5	454
Business Proprietors	0.3	28	3.4	243
Investors	(6.4)	(166)	(12.2)	(289)
Pensioners	2.3	101	7.4	257
All Others	1.2	94	3.5	261

(Figures in parentheses refer to decreases in taxes.)

The table shows that the Budget proposals begin a marked shift towards increasing the proportion of income taxes paid by employees relative to other groups, particularly investors and professionals. The latter two groups are unique in that the individuals with sufficient earned income and/or capital gains income to utilize the added pension contribution limits and the new capital gains exemption are highly concentrated in these occupational groups. (For other taxpayers the tax-increasing components of the Budget proposals tend to "catch-up" with, and surpass, the offsets). This can be seen in the proportions of taxfilers in each group who pay less under the rules in effect for each taxation year.

TABLE XI **"GAINERS" AND "LOSERS" UNDER BUDGET PROPOSALS: MANITOBA TAXFILERS CLASSIFIED BY OCCUPATION**

Occupation	% of Taxpayers Paying Less as % of all Taxpayers Affected			% of Taxpayers Paying More as % of all Taxpayers Affected		
	1985 Rules (%)	1986 Rules (%)	1990 Rules (%)	1985 Rules (%)	1986 Rules (%)	1990 Rules (%)
Employees	22.8	4.2	1.6	77.2	95.9	98.4
Farmers & Fishermen	79.7	18.1	12.4	20.3	81.9	87.6
Professionals	21.3	24.0	30.9	78.7	76.0	69.1
Salesmen	51.5	2.5	1.7	48.5	97.6	98.3
Business Proprietors	46.7	6.0	4.1	53.4	94.0	95.9
Investors	74.0	15.3	9.6	26.0	84.7	90.4
Pensioners	68.6	2.3	1.3	31.4	97.8	98.7
All Others	69.5	1.6	0.7	30.5	98.4	99.3

The apparent discontinuity between the gainers/losers under the 1985 rules and those in effect for subsequent years is the result of the relatively few taxfilers affected by the changes in place for the 1985 taxation year. (About 16% for 1985 rising to virtually all filers under the rules for later years).

For example, under the 1985 rules, 5,100 farmers are affected because only the capital gains exemption and the federal surtax are in effect for this year. Under the 1986 and 1990 rules, respectively, 21,000 and 22,800 farmers are affected. (For farmers the capital gains exemption was fully implemented for 1985; it was not phased-in gradually). Since a relatively high proportion of farmers have capital gains income, about 4,100 benefit under the 1985 rules; the other 1,000 lose due to the surtax. Under the 1990 rules, only 1,900 farmers benefit; basically, only those selling their farms have sufficient capital gains to offset the disadvantages flowing from the tax increases which take effect after 1985.

IV. THE EFFECT OF THE BUDGET PROPOSALS ON MANITOBA FAMILIES

The discussion in the previous section focussed exclusively on the proposed changes to the personal income tax system. For families with children, the Budget also proposed a number of changes to the child benefit system:

a) Family allowances are to be partially de-indexed beginning in 1986.

b) Beginning in 1986, child tax credits are increased arbitrarily according to a schedule set out in the May 23, 1985 Budget.

This schedule will result in child tax credit increases which are higher-than-otherwise in the first years and lower-than-otherwise by 1990. (After the 1988 taxation year, the child tax credit will be subject to partial indexing.)

c) The net family income threshold at which the child tax credit is reduced will be lowered from $26,330 to $23,500 for 1986. The threshold will be subject to partial de-indexing in subsequent years.

d) The exemption for children under age 18 will be reduced gradually to the same level as the family allowance.

The proposed changes to the child support system are somewhat more difficult to simulate since projections of the status quo system are required before it is possible to decide whether the existing or the proposed system are more generous for any given year. For the purposes of the simulation an annual inflation rate of 4% is assumed. (A higher inflation rate would favour the old system in the comparison since the proposed child tax credit levels up to 1990 are pre-set at fixed levels.)

The changes proposed for the child benefit and personal income tax system are inter-related; changes in family allowances -- which are taxable -- will change tax liabilities, and changes in deductions and income definitions affect net family income and may alter child tax credit entitlements. The following table shows the after-tax effects of the proposed changes to the family allowance and child tax credit levels.

TABLE XII **IMPACT OF THE BUDGET PROPOSALS ON MANITOBA FAMILIES WITH CHILDREN (TOTAL AND AVERAGE CHANGE IN FAMILY ALLOWANCES AND CHILD TAX CREDITS)**

Income Group ($)	1986 Child Benefit Changes		1990 Child Benefit Changes	
	Aggregate Effect ($M)	Average Effect ($)	Aggregate Effect ($M)	Average Effect ($)
under 7,500	1.5	85	0.5	31
7,500-15,000	1.7	95	0.5	24
15,000-25,000	1.4	40	<2.4>	<64>
25,000-50,000	<1.6>	<28>	<9.8>	<173>
over 50,000	<0.2>	<18>	<0.9>	<103>
All Groups	2.9	21	<12.1>	<86>

(Figures in brackets indicate a reduction in benefits.)

The table above shows that -- after the interactions with the personal tax system have been accounted for -- Manitoba families would

receive about $2.9 million more in child benefits under the system proposed for 1986 and about $12.1 million less under the 1990 system. In other words, for 1986 the child benefit changes will partially alleviate the effects of the income tax increases (the net tax increase faced by Manitoba families declines from $9.8 million to $6.9 million) and under the 1990 system the child benefit changes will add to the tax increases proposed in the Budget (Manitobans' after-tax incomes decline by $85.1 million instead of $73.0 million). The following table shows the combined effect of the personal income tax and child benefit systems proposed for 1986 and 1990.

TABLE XIII IMPACT OF THE BUDGET PROPOSALS ON MANITOBA FAMILIES (COMBINED EFFECT OF CHILD BENEFIT AND TAX PROPOSALS)

Income Group ($)	Change in Average After-Tax Incomes 1986 System ($)	1990 System ($)
under 7,500	76	2
7,500-15,000	14	<305>
15,000-25,000	<79>	<611>
25,000-50,000	<146>	<1,006>
over 50,000	290	92
All Groups	<51>	<604>

(Figures in brackets mean families are worse-off.)

The table supports the general observation that the Budget proposals -- as a package -- benefit low and high-income families at the expense of middle-income families. The table also suggests that the net benefit -- particularly to lower-income families -- will be phased out quite rapidly. The proportion of Manitoba families who are net beneficiaries declines from 27.4% under the 1986 package to 15.3% under the 1990 system.

V. CONCLUSION

The analysis of the impact of the May 23, 1985 federal Budget proposals suggests that only a very few -- almost exclusively high-income and/or wealthy -- Manitoba taxfilers will benefit from the Budget's personal income tax and income support measures. In aggregate, the proposals represent a significant, primarily federal, tax increase/expenditure reduction. If the income tax and child benefit system proposed for 1990 had been in place for the 1985 taxation year, the federal government's share of the tax increases/benefit decreases would have been about $140 million or about 72% of the total ($193.5 million) decrease in Manitobans' disposable incomes.

It is important to remember, however, that these tax increases and income support decreases will not be spread among all Manitoba citizens. Under the 1990 rules, the total cost to the 94% of Manitoba taxfilers who pay more and/or get less is $243.7 million. 93.8% of this total is absorbed by taxfilers reporting less than $50,000 income. In contrast, the total gain to the 6% of Manitoba taxfilers who benefit from the proposals is $50.4 million. Over 73% of the benefit accrues to about one-third of the Manitoba taxfilers who report incomes over $50,000. Only 3% of total gain accrues to families with incomes under $25,000.

The components of the May 23, 1985 Budget which were examined represent a very important shift in the pattern of taxation and family income support. The following table gives some indication of the size of the Budget effects — under the 1990 rules -- relative to the existing income tax and income support system in Manitoba. In aggregate, the changes represent a 2.3% decrease in taxfilers' disposable incomes.

TABLE XIV **IMPACT OF THE BUDGET PROPOSALS ON ALL MANITOBA TAXFILERS (CLASSIFIED BY GAIN OR LOSS POSITION)**

Income Group ($)	Losers: Total Change ($M)	Change as % of Disposable Income* (%)	Gainers: Total Change ($M)	Change as % of Disposable Income* (%)
under 7,500	<7.9>	<2.3>	0.5	0.9
7,500-15,000	<46.4>	<2.7>	1.0	2.4
15,000-25,000	<70.6>	<2.6>	2.6	5.4
25,000-50,000	<103.4>	<3.0>	9.7	5.8
over 50,000	<15.4>	<2.8>	36.6	9.4
All Groups	<243.7>	<2.7>	50.3	3.8

* Defined as "total income" less federal and Manitoba income taxes plus Child Tax Credits.

(Figures in brackets indicate taxfilers are worse-off.)

As the table above indicates, the overall effect is a very significant redistribution of burdens and benefits with upper-income Manitobans gaining at the expense of low and middle-income Manitobans. Among the "losers", the impact on disposable incomes will be quite uniform. The effect on the "gainers" disposable incomes, however, shows a very strong tendency to increase with income. Although there will be regional variations, there is no apparent reason why the general pattern should not be representative of Canada as a whole.

The analysis does not include several other important features of the May 23, 1985 Budget (and related subsequent measures). The most important of these are the changes in federal sales and commodity taxes and the corporation income tax proposals. While these measures cannot be incorporated directly in the analysis, their effect is expected to augment the patterns outlined above.

HONOURABLE VICTOR SCHRODER
MINISTER OF FINANCE
PROVINCE OF MANITOBA

NOTES FOR A STATEMENT ON TAXATION ISSUES

FEDERAL-PROVINCIAL CONFERENCE OF
FINANCE MINISTERS AND PROVINCIAL TREASURERS

HALIFAX, NOVA SCOTIA
September 26-27, 1985

I. INTRODUCTION: TAX REFORM

During the last several years, Manitoba has consistently pressed the point that a comprehensive review and reform of the Canadian tax -- and particularly the income tax -- system is long overdue. Several observations underline the urgency of moving forward decisively on this matter:

- A significant majority of Canadians no longer believe the tax system is fair. I might add that their scepticism -- even cynicism -- goes beyond Revenue Canada's collection practices, or some cases of high income individuals' escaping income taxation entirely. Many Canadians believe -- with good reason I might add -- that the Canadian tax system -- both in design and administration favours the wealthy at the expense of working people.

- We are faced with more than simply a "perceptional" problem. A paper recently distributed by the federal Finance Department showed that in 1983, over 85% of labour income was assessed for tax purpose while less than 45% of investment income entered the tax base. Ordinary working Canadians are paying more than their fair share and they know it.

- The income tax system has not generated the revenues required to finance essential public services. Programs for ordinary Canadians have been threatened and slashed and taxes which are not related to income have been steadily increased. As a result, lower and moderate income Canadians, both working and retired, have been confronted with:

  - an increasingly inequitable share of income taxes;

  - increasing reliance on taxes that are inherently less progressive than the personal income tax; and

  - cuts in important public services.

- The serious nature of the problem was underscored earlier this year when, despite an improving economic situation, Ottawa adjusted its estimates of the yield of personal income taxes down significantly, raising uncertainty about the ability of the income tax system to raise adequate revenues.

- More recently, federal analysis has confirmed the connection between declining income tax revenue productivity and the deficits facing governments throughout Canada. I quote:

"(The) drop in the rate of growth of personal income tax revenues has been a major concern and is one of the primary reasons underlying the rapid increase in the federal government's deficit over these two years (1983 and 1984)."

- Clearly, if senior governments do not act on tax reform, even greater pressure will be placed on public programs and services.

In our view, the tax package contained in the May federal Budget represents a significant step in the wrong direction. Certainly, it cannot be regarded as a reasonable approach towards meaningful tax reform.

II. CORPORATE INCOME TAX REFORM AND CORPORATE LOSS TRANSFERS

The May 23 federal Budget included a discussion paper which examined the effects of several major tax preferences and incentives on corporate income taxes in various sectors of the economy. Manitoba shares the concern that the myriad of special rules and preferences have not succeeded in furthering our country's economic objectives. Our Government also concurs — for the most part -- with the federal government's objectives as set out in the discussion paper.

However, we are disturbed by the suggestion that the rationalization of the corporate tax base would **not** be used to **help protect vital public services** in Canada, **not** be used to **help reduce taxes on ordinary Canadians**, and **not** be used to **help reduce deficits**. Instead, the Budget suggests that any rationalization of the corporate tax base be accompanied by offsetting general federal corporate rate reductions with a view to ensuring that the overall effect of corporate tax changes is "revenue-neutral."

We are therefore deeply concerned that the proposals to permit the transfer of tax losses and unused deductions within corporate groups are viewed as separate, and apparently higher priority issues. Federal estimates suggest that these proposals will reduce federal revenues by $300 to $400 million annually. Will that cost be added to the deficit? Will it be added to the taxes of other Canadians? Or will it be used as an excuse to cut other programs or services?

The proposed system of loss and unused deduction transfers is of major concern in its own right.

- In our view the tax paying unit should be either the individual corporation or the corporate group. The present proposal to allow corporations to transfer unused losses and incentives at their option, basically gives corporations "the best of both worlds" from a tax minimization perspective. The proposal

simply provides too many opportunities for corporations to avoid paying taxes.

- The existing system of incentives, preferences, and deductions which gives rise to most of the so-called "losses" should be cleaned up before any consideration is given to facilitating transfers within corporate groups.

- The proposals to facilitate such transfers within corporate groups seem at odds with the new restrictions on income splitting among family members.

- Satisfactory mechanisms to offset the impact of loss transfers among provinces have yet to be developed.

III. MINIMUM PERSONAL INCOME TAX

Our Government continues to believe that a minimum tax should be seen only as a temporary stop-gap measure and not as a substitute for comprehensive tax reform. In that sense, there is at least an equal need for a minimum tax on the corporate side.

The minimum tax itself should apply on the broadest possible base. Specifically, it should endeavour to capture those elements of income which are presently escaping the tax base. Our tax system does not require a new surcharge on labour income.

In this regard we welcome the tax expenditure account which was recently released by the federal Finance Department. The account is an important first requirement in an intensive scrutiny of the Canadian tax structure. Our Government also welcomed the recommendation of the Macdonald Commission to establish a Federal-Provincial Tax Structure Committee which would review, evaluate and set out the basic features of the tax system within a regular 5-year cycle. I would be interested in hearing the federal government's thoughts on such a proposal.

IV. VALUE-ADDED TAXATION

A value-added tax for Canada carries a number of potentially attractive advantages over the present "system" of commodity taxation. However, there are a number of important questions and issues which must be addressed before implementing such a system could be considered.

- The income redistributional characteristics of any VAT proposal must be taken into account. Our primary concern is that lower and middle income Canadians not be faced with higher-uncompensated-tax burdens.

- The regional redistribution of commodity tax burdens must be closely examined. Industries and consumers in relatively poorer provinces should not be expected to carry a larger share of the total tax burden. Of course, there may well be fairly simple mechanisms by which any regional inequities created by moving to a VAT could be neutralized.

I should also add that while our Government favours the rationalization of commodity or sales taxation in Canada, we do not believe a VAT -- with or without provincial participation -- should be regarded as the major source of new revenue. In other words value-added taxation cannot and should not be viewed as a substitute for income tax reform.

V. CONCLUSION

Essentially, Manitoba's paramount concern is that the discussion of taxation policy should not become mired in myopic debates of narrowly defined issues. Our collective goal should be to move towards an overall tax structure which Canadians in general will recognize as fair and equitable and capable of raising sufficient revenue to sustain important public services.

TAX REFORM

EXCERPTS FROM AN ADDRESS
BY THE HONOURABLE HOWARD PAWLEY
TO THE 1985 PREMIERS' CONFERENCE
AUGUST 20-22, 1985
ST. JOHN'S, NEWFOUNDLAND

At last year's Premiers' Conference in Charlottetown and again at the First Ministers' Conference in Regina, Manitoba stood alone in raising the tax reform issue. I am pleased to note that since then Saskatchewan has joined us in pushing for national tax reform and, at Grande Prairie in May, all four Western Provinces endorsed a communique calling for national tax reform.

The case for reform is strong. It arises from the myriad of incentives, preferential provisions and loopholes now contained in our tax system. The magnitude of the abuses is such that numerous wealthy Canadians and profitable corporations are able to avoid paying any taxes, and growing numbers of Canadians believe the system is unfair.

In 1962, the then Prime Minister, the Right Hon. John Diefenbaker, established a Royal Commission, chaired by Mr. Kenneth Carter to study Canada's system of taxation. The 1966 Report of the Commission described the objectives of a nation's tax system:

> "The first and most essential purpose of taxation is to share the burden of the state fairly among all individuals and families. Unless the allocation of the burden is generally accepted as fair, the social and political fabric of a country is weakened and can be destroyed."

It has become increasingly apparent that, by these standards, Canada's income tax system is failing miserably.

1) Income taxes have become increasingly unfair and inequitable. Our Government has always endorsed the position of the Carter Commission that taxes should reflect ability-to-pay. As the Commission expressed it:

> "All resident individuals and families should pay taxes on a base that measures the value of the annual net gain or loss in the unit's power, whether exercised or not, to consume goods and services. Such a base would ignore the form of the gain or what was done to obtain the gain. We call this the comprehensive tax base."

In fact, this principle often referred to as "a buck is a buck" is grossly violated in the present system. In 1983, for example, over 85% of labour income was assessed for tax purposes. In contrast, less than 45% of investment income entered the tax base in that year. **Clearly, ordinary, working Canadians are paying more than their fair share.**

2) The income tax system has not generated the revenues required to finance essential public services. Programs for ordinary Canadians have been slashed and taxes which are not related to income have been steadily increased. As a result, lower and moderate income Canadians, both working and retired, have been confronted with:

- an increasingly inequitable share of income taxes;
- increasing reliance on taxes that are inherently less progressive than the personal income tax; and
- cuts in important public services.

The serious nature of the problem was underscored earlier this year when, despite an improving economic situation, Ottawa adjusted its estimates of the yield of personal income taxes down significantly, raising uncertainty about the ability of the income tax system to raise revenues.

More recently, federal analysis has confirmed the connection between declining income tax revenue productivity and the deficits facing governments throughout Canada. I quote:

> "(The) drop in the rate of growth of personal income tax revenues has been a major concern and is one of the primary reasons underlying the rapid increase in the federal government's deficit over these two years (1983 and 1984)."

Clearly, if senior governments do not act on tax reform, even greater pressure will be placed on public programs and services.

In our view, the tax package contained in the May federal Budget represents a significant step in the wrong direction. Certainly, it cannot be regarded as a reasonable approach towards meaningful tax reform.

On the personal side, major tax cuts are provided for the wealthy through the $1/2 million capital gains exemption and the increases in tax deductible pension contributions for higher income earners. Clearly, these cuts, entailing a cost of $2.3 billion annually by 1990/91, for the more fortunate are not helping to reduce the federal deficit, nor are they helping secure the resources needed for important public services.

On the corporate side, the Budget proposed new measures to permit transfers of tax losses, largely unused tax incentives and deductions, within corporate groups. The proposal will result in significant revenue losses federally ($400 million annually) and unspecified losses provincially.

In a separate discussion paper on corporate income taxes, the federal government identified major tax preferences which should be examined in the interests of providing a more fair and rational corporate income tax base. These included accelerated capital cost allowances in excess of actual depreciation, preferential tax rates, resource write-offs, the investment tax credits, and the inventory valuation allowance.

Our Government fully supports a comprehensive review of the corporate income tax base. Moreover, in our view, it is important that this review be completed and the existing corporate tax system cleaned up before considering any broadening of the transferability of unused tax deductions and preferences among corporations.

Our Government has long felt than an objective review of the corporate tax system would confirm that many preferences have either outlived their usefulness or are not effective. In our view, those provisions should simply be rescinded with the bulk of the resulting revenues used to help provide a more secure base for important public services and to increase federal fiscal flexibility.

It was therefore particularly disturbing to hear the federal government suggest that rationalization of the corporate tax base not be used to help protect vital public services in Canada, not be used to help reduce taxes on ordinary Canadians, and not be used to help reduce deficits. Instead, the federal Minister of

Finance has suggested that any rationalization of the corporate tax base be accompanied by offsetting general federal corporate rate reductions with a view to ensuring that the overall effect of changes is "revenue-neutral."

Our Government does not believe that suggestion to be appropriate or fair, particularly at a time when the federal government, on the basis of concern over its own fiscal flexibility, proposed cuts in Old Age Pensions, cuts in social and economic programming, and cuts in its support for health, education and equalization throughout the country.

I ask all Premiers to join in urging the federal government to undertake a broadly based, intensive, National Tax Reform Conference. Such a Conference, which should include not only provincial governments, but also Canadians from all walks of life, would be the first step towards a truly meaningful consultation process.

The costs of allowing tax policy to be formulated in the bowels of federal Finance, accessible only to corporate tax planners, are obvious. Clearly, the time has come to open this important function of government to all Canadians.